



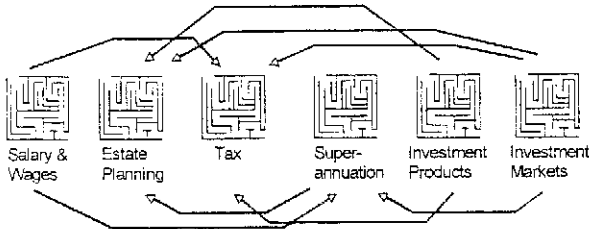
Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (b)

Submission No. 19 (Supplementary to Submission
No. 17)

Note: Also Submission No. 55 to References (a) + (c)

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30 June, 2000

Ms Sue Morton
 Secretariat, Senate Select Committee on Superannuation & Financial Services
 Parliament House
 Canberra ACT 2600

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Re: Further comment on questions asked by Senators at the Brisbane public meeting.

Dear Sue

As you know, I was asked to attend the Brisbane committee meeting on 16th June. I have been giving further thought to some of the questions that Senators asked me on that day. These issues include the following:-

- Senator Lightfoot asked what would I do with **an investor who wanted high returns but no risk.** This is a very important question, which financial planners are often faced with. I enclose a copy of the FPA's Practice Guideline for Risk Disclosure. This might help the Senators understand how as financial planners we need to deal with this, and why. If you refer to Section 2.11 on page 5, you will note **our obligation to "provide an explanation of the nature of the investment risks involved in terms that the client is likely to understand."**

Explaining the nature of the investment risks involved in terms that the client is likely to understand is a non-trivial task. It involves making a proper assessment of the client. It also involves the process of explaining. But most importantly, it involves the education of the client. And as I mentioned in answers to questions on the 16th June, it is my experience that the education process (to get a client to a level of knowledge that I might be happy with) to best help a client achieve their objectives, takes about 2-3 years. (Just to complicate things, as we have seen over the last few years, the experts don't always agree on the "nature of the investment risks", as experts have argued over whether we were seeing a classic speculative bubble in stock markets or whether there was a sustainable basis for some very high Price/Earnings ratios.)

It is therefore very clear that Senator Lightfoot was putting his finger on a very key issue. Because a financial planner must **"provide an explanation of the nature of the investment risks involved in terms that the client is likely to understand"**, the financial planner cannot provide the best possible advice *until the investor is prepared to learn and understand about investment risks.* Sometimes it takes new clients and regulators a while to appreciate this point. And because this task is usually non-trivial, necessarily the costs are non-trivial.

- **A number of questions (from Senators) suggested to me that the role of a financial planner was not clear.** While it is true that there is a wide range of different types of services from different financial planners (as there is a wide range of different types of services from accountants), there are

Puzzle Financial Advice - Senate letter 000626-1



some common themes in the role of the financial planner. I enclose a few pages from the "Users Guide" that I give new clients (not for publication ... just to assist the understanding of the committee). This should give you a greater sense of the tasks involved ... and why financial planning is such a time-intensive task.

I also sense that Senator Sherry is sensitive about the magnitude of costs of a financial planner. Perhaps the Users Guide, by helping to clarify the amount of time required, will also help Senator Sherry appreciate why costs are what they are. One of the challenges before the Committee (and perhaps before the financial planning community) is how some subset of quality financial planning services can be made more available to the public. From an advisor's perspective, **one of the biggest obstacles to providing a lower cost subset of services, is financial risk to the advisor.**

Perhaps Senator Sherry's concern about costs relates to over-charging by some advisors, failure to disclose fees or some other unethical behaviour. Unfortunately, as with all professions, there is always going to be some who do not behave as ethically as the community would like. The Financial Planning Association (FPA) is also very concerned to eliminate unethical behaviour and I think you will find that it is increasingly difficult for an advisor to retain membership of the FPA, if there is evidence of unethical behaviour. However, clearly the FPA cannot impose sanctions on advisors who are not members of the FPA.

- **Lyn Allison asked whether there was "any other relevance" of the mining industry's seemingly poor performance.** My understanding is that the Committee is interested in *Australia becoming a financial centre for Asia*. Why would we want Australia to become a financial centre for Asia? Surely the only reason could be, "that by doing so, we could improve the standard of living for Australians". So one of the points I was making was related to the broader question, of "what obstacles there were to Australians having a higher standard of living". My view was that I felt that, in its current form, the mining industry may be more of an obstacle to a higher standard of living, than a help. From the graphs that I provided the committee, superficially it would seem (from a Boston Consulting Group style of classification) that the mining industry in its current form, is a "dog". The Boston Consulting Group (BCG) would go on to suggest that with a "dog", you should be looking to either 1) turn it into a "cash cow" [eg by requiring higher royalties], or 2) **get rid of it**, or take some other action to help it make a positive contribution. It seems unlikely that you could revert the mining industry back into a "star" (the remaining BCG classification) as it clearly was early in the twentieth century.

Please also note that the enclosed AFR news article which raises some related issues.

- Further, on the question of **Australia becoming a major financial centre for Asia**, in my 14th June submission extension, I suggested that this was a pipe dream. Yes, I do think that there are short-term opportunities for Australia to sell more our expertise for financial services into Asia, but over the medium-term I think that it is already virtually certain that the major financial centre for Asia (outside of Japan) will be Asian. I think we are already in the end-game of these developments and probably too late for Australia to have a major bearing on the outcome. (This is not to say that Sydney cannot play some more minor role as a financial centre in the region ... or play a role in co-operation with the world's major financial centres). The only question is, what form it will take. So let us consider what form it might take, because that will help us to understand how Australia can play a more complementary role.



Tokyo is already a major financial centre in Asia of course. Where else might a major financial centre spring from? I would ask you to think 10 or 20 years down the track, and think of the possibilities. Let us consider the economies of Singapore, Taiwan and Hong Kong, and let us compare this to Australia.

	<u>Population</u>	<u>GDP in US\$</u>	<u>Per Capita GDP in US\$</u>
Australia	19million (2000)	US\$367b (1996)	US\$20 090 (1996)
Singapore	3.2million (1998)	US\$93b (1996)	US\$30 550 (1996) ie. 1.5 x Aust
Hong Kong	6.6million (1998)	US\$153b (1996)	US\$24 290 (1996) ie. 1.25 x Aust
Taiwan	21.8million	US\$297b (1998)	US\$13 900 (1998)
S+H+T	31million	US\$543b	

Source: Encyclopaedia Britannica

Why are these statistics of relevance?

- What if, over the next 10 years or so, **Singapore, Taiwan and Hong Kong** created a merged financial centre? **Please note that in combination, these 3 economies already have a 50% larger economy than Australia** and a 50% larger population. Keep in mind that a few weeks ago in Sydney, the deputy prime minister of Singapore expressed a view that it was "inevitable" that Taiwan would be merged back into China. With the globalisation of the world (for companies and countries), opportunities like the merging of the above three will probably become political imperatives. However, other patterns may well develop and perhaps we might influence the final patterns if we put our minds to it. Lets make sure we focus our efforts where we can have the biggest influence in improving the standards of living for Australians.
- I also wanted to use these statistics to further highlight how far we have already fallen behind the per capita GDP of some of the countries to our north. Needless to say, Japan's per capital GDP is already twice ours. As a country, we must focus on this problem or we truly will become the poor nation in Asia. While this is not the focus for your committee, **I think your committee (together with others) has to consider this issue.** Your committee can help Australia find solutions to this problem. Otherwise, why even bother considering the question of "making Australia a larger financial centre?"

Yours Sincerely

Bruce Baker BSc(Stats) MBA DipFinPlanning

Certified Financial Planner

Director & Authorised Representative, Puzzle Financial Advice Pty Ltd

Enclosures:

FPA Risk Disclosure Guideline.

Excerpts from my "Users Guide" to give you a greater sense of the process of financial planning.

AFR article "How the West lost its sway in the East" dated 21/6/00.

AFR article "Resource sector under siege" dated 29/6/00.

Corrected Hansard of the Committee meeting of 16th June 2000. — not included in submission

Published as attachment to Submission 55 to referees (a) & (c)
NOT PUBLISHED

How the West lost its sway in the East

Peter Hartcher reports on a new anti-westernism among East Asia's elite.



Australia is on the wrong wavelength in Asia: resentment against the West is just too strong at the moment.

Photo: AP

Not only white, but beyond the pale

Peter Hartcher

Why can't Australia be included in the new groupings taking shape in Asia? "Because you are white," comes the answer from a leading intellectual and former Finance Secretary in the Philippines, Dr Jesus Estanislao.

Don't get him wrong. He supports Australia and New Zealand's inclusion. "There are a number of us who are very uncomfortable with a narrow, racially based regionalism."

"But despite all the denials, much of the energy driving the new agenda is just that. It has a strong emotional momentum," says Dr Estanislao, the Philippines representative on APEC's Eminent Persons Group.

"That's why it's a good idea to bring Australia and New Zealand in - it would defuse it, make it less racial, more open, to make sure we

don't create a dividing line across the Pacific."

Dr Estanislao, Harvard educated, was Cory Aquino's Secretary of Economic Planning and later Finance Secretary. He is now, among other things, president of the Institute of Corporate Directors.

"Australia and New Zealand also have a lot to bring to the table - on corporate governance for example, where you have a different experience and therefore a good contribution to make."

But the climate of Asian neo-nationalism and resentment against the West is just too strong at the moment, he says.

He adds that Australia damaged itself in the eyes of the region by being seen to be too aggressive and jingoistic in East Timor. "That hardened sentiment against Australia."

Australia has not been invited to join the new trade, finance or political groupings taking shape in East Asia.

But the region looms particularly large for Australia - it buys exactly half of everything that Australia sells to the world. It is also, of course, the region in which Australia must find its security.

The senior deputy governor of the central bank of Indonesia, Professor Anwar Nasution, says that Australia should be included: "You bring some of the good Anglo-Saxon traditions with you, for example your approach to education."

"In East Asia we still have the mandarin model - you have to massage the leg of the guru before he will tell you anything."

"Australia is not a big market but you are rich in resources and ideas."

The Japanese first advanced this idea in 1997 as the crisis broke. It was vetoed by the US and opposed by Australia. These governments feared it would be a Japanese-run slush fund for buying political influence, handing money unconditionally to countries in crisis.

This left the IMF as the unchallenged dispenser of emergency credit, the arbiter of economic policy across half of Asia.

As a result, *Asiaweek* magazine decided that the most powerful man in Asia in 1998 was not an Asian or even a resident of Asia, but the IMF's then managing director, Mr Michel Camdessus. Although Mr

Camdessus is French, his policies were widely seen as being those of the IMF's biggest shareholder, the US Government. This smarted.

So now the idea of an Asian fund has new momentum. East Asian elites are being drawn together by a powerful sense of post-crisis regionalism. It is part reason, part emotion.

It extends well beyond the Asian Monetary Fund. There is new vigour in exploring regional arrangements in finance, trade and politics.

"At the time of the crisis in Asia, people were sceptical about regional solutions. But now there is a groundswell in favour of them," said a man who works closely with govern-

ments on these issues, the manager of the regional economic monitoring unit at the Asian Development Bank, Mr Pradumna Rana.

"Trade co-operation is already under way and now we are moving into monetary areas. It's a regional watershed."

"You have to understand how dramatic this change is. ASEAN [the Association of South-East Asian Nations] for 30 years had a principle of non-interference in each other's affairs. Now governments are submitting to peer review of their economic policies."

"It is maybe not so different to Europe in the late 1950s," he said.

referring to the dawning of European integration.

Japan dominates the economy of East Asia. Its annual output is worth about \$US4.5 trillion, about half that of the US. Even after a decade of stagnation, Japan's is still the world's second-biggest economy and twice the size of that of the next-ranked, Germany.

The rest of East Asia - the larger northern economies of China and South Korea, plus the clutch of 10 smaller ASEAN members - has an annual output worth \$US2.1 trillion. The region's total economy of \$US6.6 trillion means it accounts for about a fifth of world output.

These countries are already more closely integrated: collectively, 55 per cent of all East Asian trade is with other East Asian countries, compared to only 30 per cent in 1996.

Now they are working on agendas that would bring them much closer.

In trade, there is feasibility work under way on two major initiatives. Both are in their infancy. One is the ASEAN Plus Three proposal for a free-trade area embracing all East Asia. The other is for freer trade between Japan and South Korea.

In finance, the governments of East Asia agreed last month on the so-called Chiang Mai Initiative, a network of currency swaps between member countries to allow them greater liquidity in the event of crisis. Now there is pressure to move towards an Asian Monetary Fund.

In politics, there is a mushrooming of meetings, but the most significant may be the ASEAN Plus Three agreement to an annual heads-of-government meeting.

But there are as many differences between the East Asians as similarities, and obstacles aplenty to integration.

The chief strategist at Singapore consultancy Strategic Intelligence, Dr Yuwa Hedrick-Wong, said:

"There might be something in it politically for the ASEAN Plus Three to get together, but from an economic point of view this so-called new regionalism is already an anachronistic idea."

"There is a global market and these countries are part of it. For example, everyone except Malaysia has given up on the idea of a national car project - the Chinese, the Thais, the Indonesians and the Koreans have all abandoned the idea."

The Korea Exchange Bank's Mr Park agrees that there are problems to surmount in advancing regional integration: "The only way to get a consensus in East Asia," he quipped, "is for me to threaten to punch all the other guys."

■ This concludes a three-part series.

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AFR 29/6/00

Resources sector under siege



Nonchance to hide...resources companies are increasingly becoming the targets of unwelcome interest from overseas. Photo: VICTORIA STAR

Ian Howarth and Bruce Hextall

North Ltd yesterday mounted an aggressive defence against Rio Tinto's \$2.8 billion takeover bid, labelling it "a very cheap opening shot" that was "trying to cheat the shareholders".

But North's managing director, Mr Malcolm Broomhead, is not the only resources chief executive who is feeling vulnerable.

Rio's hostile bid has highlighted the plight of Australia's resources companies. Once the backbone of the sharemarket, they are now the prey of offshore predators.

Although the resources sector is forecast to produce a record \$46 billion in exports in 2000-01, the weak Australian dollar, poor earnings performances and open share registers have made NIM, Pasminco, WMC and Anaconda Nickel prime targets.

Only 10 years ago, the resources and oil sector made up about 40 per cent of the stockmarket's All Ordinaries Index. Today, it accounts for less than 16 per cent following the emergence of telecommunications and demutualised insurance and funds management groups.

In the wake of Rio's bid for North and Shell's grab for control of Woodside Petroleum, international resource groups are now evaluating several balance sheets in Australia's mining and oil sector.

Yesterday, Mr Broomhead also took the unusual step of quitting his executive duties to head a team of executives and advisers that will try to extract a higher bid for Australia's third-largest iron ore producer.

The move came as Rio revealed the takeover would deliver up to \$400 million in savings from merged iron ore operations in the Pilbara region of Western Australia.

Rio's takeover play is seen by analysts as the start of a shake-out that will involve international groups bidding for local companies and rationalisation among the domestic players, with BHP and the Normandy Mining

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AFR MAGAZINE

Four men & a wardrobe
Who says blokes can't dress? These role models strut their stuff.
By Malsande Clarke

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C&W dials Optus mobile buyers

Christine Lacy

Telecom New Zealand is investigating the purchase of Cable & Wireless Optus's \$15-billion mobile phone business following an approach by Optus's United Kingdom-based parent.

It is believed Cable & Wireless PLC has also sounded out other international players about a possible sale of Optus's very profitable business, which boasts 33 per cent of the local mobile market.

Telecom NZ is understood to be

second-ranked Australian mobile player as part of a strategy to create a pan-Asian mobile venture, similar to the operation being put together by Telstra Corp and Mr Richard O'Leary's Pacific Century CyberWorks.

News of the negotiations has raised fresh speculation about a break-up of Cable & Wireless Optus, which would in effect see Optus disappear from the consumer telecommunications market in Australia.

The break-up has been constantly denied by the management of the Australian subsidiary, which gener-

ally mobile business. But it is believed the approach to Telecom NZ came directly from the UK, with local management not involved in the talks.

Optus's chief executive, Mr Chris Andersson, is on leave, but a company spokesman said yesterday any suggestion that the mobiles business was being sold was "untrue".

"The story that our mobiles business is being sold is completely untrue," he said, denying that any potential buyers had been sounded out.

Optus's managing director of the mobiles business, Mr Paul O'Sullivan,

Resources sector under siege

From page 1

group well positioned to expand.

While Normandy is one of the world's largest gold producers, it could also be a target for the likes of South Africa's AngloGold and Barrack Gold of the US because of its premium suite of Australian assets.

BHP has concentrated on a massive restructuring under chief executive Mr Paul Anderson, who has put the company in a position to become a major global minerals player through acquisitions and alliances.

The drop in importance has not been restricted to Australia, with the total market capitalisation of global resource companies at about \$US400 billion (\$670 billion), or about 2 per cent of the capitalised value of the world stocks.

A globalisation in the sector, highlighted by mergers in the oil industry and Rio Tinto's takeover of CRA and mop up of Comalco, has also contributed to the massive reduction in its weighting in the equities market.

The demise of local ownership has raised concerns about "selling off the farm", although the Federal Government is unlikely to slow the process through its foreign investment laws.

"We certainly haven't picked up any barrage from the Government on rationalisation in the sector being detrimental to Australia," said Australian Gold Council executive director Mr Greg Barns.

He said that if regulatory hurdles, including Foreign Investment Review Board requirements, were overcome, the Government was supportive.

"It is a two-way street. It is an industry which is becoming increasingly borderless," Mr Barns said.

The need to get bigger to compete globally is expected to trigger the rationalisation in Australia.

There were "a variety of reasons for the accelerating pace of takeovers", Rothschild Australia Asset Management's resources portfolio manager, Stuart Dodd, said.

The low value of the Australian dollar had helped. But, Mr Dodd said the cheapness of Australian resource stocks relative to international companies was a bigger factor.

It is a question of value, and



Explosive issue? North has labelled Rio Tinto's takeover bid 'a very cheap opening shot'.

Photo: VIRGINIA STAR

right now the managers of resources companies are recognising it is more rational to grow their businesses through mergers and acquisitions," he said.

The largest of the mooted takeover targets is WMC, which could become a break-up play.

Its alumina joint venture partner, the financially strong Alcoa Inc, could take the opportunity to gain control.

Analysts are divided about whether WMC is a target or an acquirer. It is tipped as a likely buyer of North's uranium offshoot, Energy Resources of Australia, should Rio succeed with its bid for North.

Companies with corporates as a strong presence on their share registers are also obvious targets.

These include Goldfields, which now has South Africa's Harmony Gold as a 19.9 per cent shareholder; minerals sands producer Ticor, already controlled by South Africa's Iscor; and coal group QCT Resources. QCT could be in play after oil and gas producer Santos Ltd decided its 34 per cent stake in the Brisbane-based company was no longer a core investment.

In the oil and gas sector, Oil Search could be vulnerable once development approval of the PNG-to-Queensland gas pipeline was gained. Woodside has approximately 15 per cent of the company.

Laterite nickel miners Ana-

conda Nickel and Preston Metals also possess valuable assets.

Anaconda's price soared to its highest level in three years this week after major shareholder Anglo American revealed it had increased its stake to 24.16 per cent from 23 per cent.

According to some analysts, many of the best operators have already fallen victim to takeovers or mergers.

"The demise of local ownership has raised concerns about selling off the farm."

"We are running out of suspects," BT Funds Management's head of equities, Mr Steve Giubin, said. "The bane of the [resources] industry has been very poor returns on capital employed."

The drive for global resource-sector mergers was driven by the need to improve capital returns.

This was being achieved by company mergers to produce growth rather than building new mines that added to global production, forcing commodity prices lower and damaging company profits.

"The listed [resources] sector will shrink and it has only itself to blame because of its poor

Also Govt policy.

return on capital over a long period," Mr Giubin said.

Among the prey in the past year have been QNI Ltd, Comalco Ltd, Ross Mining, Acacia Ltd and Great Central Mines, who have all disappeared from the stock exchange.

Nevertheless, companies such as AngloGold and US-based Homestake Mining are showing an unabated appetite for Australian assets.

Yesterday in Paris, AngloGold executive director Mr Kevin Williams reiterated his company's interest in local stocks even after recently acquiring Acacia Resources. He said AngloGold would buy more Australian assets but was interested only in companies that produced gold at under \$US200 an ounce.

Aurora Gold and Delta Gold (before its recent Solomon Islands problems) each fell in that category.

Recently the bulk of Australia's coal industry has been sold in a dramatic consolidation of ownership, and the world's aluminium industry has contracted to five main players.

Rio Tinto's move to 100 per cent ownership of Comalco was followed by Capral Ltd's sale of its Kurri Kurri aluminium smelter to Germany's VAW group. In Victoria, Alcoa took over Eastern Aluminium to consolidate its position as major owner of the Portland Smelter.

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